



April 12, 2006

Mary Rupp  
Secretary of the Board  
National Credit Union Administration  
775 Duke Street  
Alexandria, Virginia 22314-3428

Dear Ms. Rupp:

I am writing to comment on whether and how to modify the NCUA Supervisory Committee audit rules to require credit unions to obtain an "attestation of internal controls" in connection with their annual audits, to identify and impose assessment and attestation standards for those engagements, to impose minimum qualifications for Supervisory Committee members, and to identify and impose a standard for the independence required of State-licensed, compensation auditors.

I am currently Chair of the Supervisory Committee of Teacher Federal Credit Union and a CPA who specializes in business valuation with my consulting practice. I have also assisted several public companies with implementation of the requirements of the Sarbanes-Oxley Act of 2002. Therefore, I believe that I provide a unique perspective.

My overall viewpoint and recommendations are based on considering the reasons why the Sarbanes-Oxley Act was passed in the first place. For the most part, it was enacted to combat the greed and unethical behavior of a relatively few executives at very large publicly-held companies and to protect the investing public from future fraud. Results of the enactment of SOX include:

- 1) Help improve investors' perception by sanctioning and regulating public companies' financial control systems and reporting.
- 2) Very high costs to implement.
- 3) Provided a windfall for CPA and consulting firms that provide Sarbanes-Oxley consulting services.

We currently find ourselves in a situation where smaller publicly-held companies, defined by the SEC as those having a market value of less than \$75 million, have had the required implementation date for SOX extended until 2007. They are in the process of lobbying for an easing of the regulations, primarily because of the excessive costs of implementation and continuing compliance.

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I do not see any correlation between the current state of the credit union industry and that of the business environment earlier in the decade when Enron, WorldCom, Tyco and subsequent misdeeds came to light. I believe the vast majority of credit unions are safe, sound and adequately controlled. Some of the reasons for this include the involvement of volunteers at various levels in oversight of the credit union, the targeted focus on member services that spreads risk through homogenous loans to members and appropriate investment of funds. For the most part, I believe management of credit unions do not have the motivations and pressures that executives of publicly-held companies have. Therefore, I believe a mandated Sarbanes-Oxley Act solution is not in the best interests of credit unions.

It's interesting that the credit union industry has had the "no taxation" issue on its agenda for over twenty years, arguing that it would be unfair and costly to its membership, especially when considering the relatively low effective income tax rates of banks which could be extrapolated to credit unions. Implementing an across-the-board SOX attestation regulation on credit unions could exceed the costs of income taxation.

I believe a targeted implementation of rules similar to those in the banking industry under FDICIA would be much more appropriate for the credit union industry, with the threshold being those credit unions with assets in excess of \$1 billion – the ones who can afford the costs of implementation and compliance. This should be consistent with the FDICIA parameters for banks.

My recommendation for those credit unions with assets less than \$1 billion is to enhance the quality of continuing education of management, internal auditors, Supervisory Committee members and members of the credit union's Board of Directors to focus on ethical behavior, internal controls and risk management. I also think it would be beneficial to "cherry pick" some of the SOX controls documentation and assessment guidance based on "benefits vs. costs" and recommend – but not regulate – their implementation.

I hope my comments are useful to you, and that I communicate specific ideas in the responses to your questions that were included in your invitation to comment.

Please contact me at (612) 384-8243 if you have any questions or comments.

Sincerely,



Kevin Sullivan, CPA/ABV

**Comments on Potential Revisions to NCUA Regulation 715  
Provided by Kevin Sullivan, CPA/ABV  
Sullivan & Co., Ltd  
April 12, 2006**

**II. Issues for Comment**

**A. Internal Control Assessment and Attestation**

*Question No. 1:* Should part 715 require, in addition to a financial statement audit, an “attestation of internal controls” over financial reporting above a certain minimum asset size threshold? Explain why or why not.

Yes, but only if it is similar to the FDICIA requirements for federally-insured financial institutions and it has the same requirements – for institutions with assets exceeding \$1 billion. The costs of complying with more stringent requirements would put the credit union industry at a competitive disadvantage, and Sarbanes-Oxley requirements address problems that are not, and likely never will be, prevalent in the credit union industry.

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*Question No. 2:* What minimum asset size threshold would be appropriate for requiring, in addition to a financial statement audit, an “attestation on internal controls” over financial reporting, given the additional burden on management and its external auditors? Explain the reasons for the threshold you favor.

On those credit unions with assets exceeding \$1 billion as mentioned above, primarily because the costs associated with the initial and continuing compliance will likely exceed the benefits derived for the risks being managed in the industry.

*Question No. 3:* Should the minimum asset size threshold for requiring an “attestation of internal controls” over financial reporting be the same for natural person credit unions and corporate credit unions? Explain why.

Yes. There should be no discrimination between whether a “natural person” or corporate credit union since both expose the members to similar risks.

*Question No. 4:* Should management’s assessments of the effectiveness of internal controls and the attestation by its external auditor cover all financial reporting, (i.e. financial statements prepared in accordance with GAAP and those prepared for regulatory reporting purposes), or should it be more narrowly framed to cover only certain types of financial reporting? If so, which types?

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I believe the current system should be modified to conform regulatory reporting so that it is the same as generally accepted accounting principles. The differences between the two are typically immaterial, and this change would provide for efficiencies and reduce costs of complying with more than one set of accounting rules.

Absent any modifications to the current system, the assessments of the effectiveness of internal controls and the attestation by the external auditor should cover all financial reporting since the financial reporting systems – both GAAP and RAAP – should both be subject to the effectiveness assessment and attestation. To leave one outside the parameters does not make sense.

*Question No. 5:* Should the same auditor be permitted to perform both the financial statement audit and the “attestation of internal controls” over financial reporting, or should a credit union be allowed to engage one auditor to perform the financial statement audit and another to perform the “attestation of internal controls?” Explain the reasons for your answer.

Using the same auditor to perform the financial statement audit and attest to the effectiveness of internal controls should be permitted; this would be parallel to the Sarbanes-Oxley requirements. However, the accounting or consulting firm that is engaged to assist with management's documentation and assessment of controls should always be different than the firm that performs the financial statement audit and also attest to the effectiveness of management's assessment of internal controls; again, the same as current SOX requirements.

Credit unions should be allowed to engage one auditor to perform the financial statement audit and another to perform the “attestation of internal controls”, however, I believe the costs associated with doing that will be found to be prohibitive and most credit unions will choose to engage the same auditor for both.

*Question No. 6:* If an “attestation on internal controls” were required of credit unions, should it be required annually or less frequently? Why?

Annually, similar to FDICIA and Sarbanes-Oxley requirements since that is the most logical parameter to require. Risks and controls evolve and change, and requiring the attestation less frequently than annually would have a significant negative impact on its effectiveness.

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*Question No. 7:* If an “attestation on internal controls” were required of credit unions, when should the requirement become effective (i.e., in the fiscal period beginning after December 15 of what year)?

The later of two years after the Smaller Public Company requirement date (companies with a market value of less than \$75 million) or 2009. This will provide some time to use the results obtained from the smaller publicly-held companies' implementation efforts, as well as spread out the use of resources that will be required for the implementation efforts.

B. Standards Governing Internal Control Assessments and Attestations

*Question No. 8:* If credit unions were required to obtain an “attestation on internal controls”, should part 715 require that those attestations, whether for a natural person or corporate credit union, adhere to the PCAOB's AS 2 standard that applies to public companies, or the AICPA's revised AT 501 standard that applies to non-public companies? Please explain your preference.

The AICPA's revised AT 501 standard, because credit unions are not publicly traded companies, and the AICPA standard is the appropriate standard to use for non-publicly traded entities.

*Question No. 9:* Should NCUA mandate COSO's *Internal Control – An Integrated Framework* as the standard all credit union management must follow when establishing, maintaining and assessing the effectiveness of the internal control structure and procedures, or should each credit union have the option to choose its own standard?

According to recent articles, COSO's integrated framework is used by over 80% of all publicly-held companies that have completed their first year of internal control assessment and testing under the rules of Sarbanes-Oxley. The COSO integrated framework should be encouraged but not required. Credit unions should receive information and training on the pros and cons of the various frameworks and be allowed to decide which framework is appropriate for their circumstances. It should never be mandated.

C. Qualifications of Supervisory Committee Members

*Question No. 10:* Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be required to have a minimum level of experience or expertise in credit union, banking or other financial matters? If so, what criteria should they be required to meet and what should the minimum asset threshold be?

Similar to SOX requirements, there should be at least one member of the Supervisory Committee who is designated a “financial expert” and has the experience and background in accounting and finance and, preferably, experience with the financial services industry. The Sarbanes-Oxley criteria defining a financial expert could be modified to fit credit unions. I believe this should be required for credit unions with total assets of \$500 million or more, and encouraged for all other credit unions. Any asset threshold should be meant for credit unions that have more sophisticated operations and risk exposure; perhaps the NCUA or others in the industry have a better idea of what the appropriate threshold should be.

Another area where credit unions would benefit from SOX practices would be to elevate and emphasize the importance of the Supervisory Committee and require that at least one member of the Committee also be a member of the Board of Directors of the credit union.

Though not specifically asked for, I also believe it’s probably an appropriate time to abandon the “Supervisory Committee” terminology and use the common term of “Audit Committee”. This would better align credit unions with the language used in the current environment.

*Question No. 11:* Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be required to have access to their own outside counsel? If so, at what minimum asset size threshold?

This should not be a requirement. Instead, Supervisory Committee members should be made aware through training that this resource may be needed, and provide specific examples of when the use of outside counsel should be considered. I believe the current Supervisory Committee manual has limited information on this topic.

*Question No. 12:* Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be prohibited from being associated with any large customer of the credit union other than its sponsor? If so, at what minimum asset size threshold?

Since more credit unions are providing commercial loans, this topic may become more relevant; however, I do not believe this would affect a large number of credit unions. Therefore, I think it would be appropriate to require all credit unions to prohibit any Supervisory Committee member to be associated with any large customer of the credit union other than its sponsor.



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*Question No. 13:* If any of the qualifications addressed in questions 10, 11 and 12 above were required of Supervisory Committee members, would credit unions have difficulty in recruiting and retaining individuals to serve in sufficient numbers? If so, describe the obstacles associated with each qualification.

Yes, anytime a new requirement is implemented, there is usually some pain and difficulty with complying with the requirement. However, I do not believe the recommendations I made in response to these questions is unduly burdensome. There are a number of resources available in the Sarbanes-Oxley literature that address concerns about audit committees recruiting the right talent which I think would be useful for credit unions. Please refer to the websites of the American Institute of Certified Public Accountants, the Public Company Accounting Oversight Board, as well as various other resources on this topic that are available to the public.

Independence of State-Licensed, Compensated Auditors

*Question No. 14:* Should a State-licensed, compensated auditor who performs a financial statement audit and/or "internal control attestation" be required to meet just the AICPA's independence standards, or should they be required to also meet the SEC's "independence" requirements and interpretations? If not both, why not?

The AICPA's independence standards, because those standards are stringent enough and credit unions are not publicly traded entities and should not be subject to the same requirements.

Audit Options, Reports and Engagements

*Question No. 15:* Is there value in retaining the "balance sheet audit" in existing Section 715.7(a) as an audit option for credit unions with less than \$500 million in assets?

To adequately answer this, I would need to know how many credit unions use this option. I would speculate, and hope, that the vast majority of credit unions do not. The majority of CPA firms discourage clients from hiring them for "balance sheet only" audits, other than in some cases where the client has never been audited and there may be cut-off issues on prior year balances. In most cases, I believe the fees for obtaining an audit of all of the basic financial statements do not significantly exceed the fees for a "balance sheet only" audit. It's a much better decision to have all the basic financial statements audited. Therefore, I recommend eliminating this option for credit unions.

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*Question No. 16:* Is there value in retaining the “Supervisory Committee Audit Guide audit” in Existing Section 715.7 (a) as an audit option for credit unions with less than \$500 million in assets?

Yes. I think members of Supervisory Committees and Internal Auditors appreciate the Guide and consider it to be a good resource. However, it should be updated annually.

*Question No. 17:* Should part 715 require credit unions that obtain a financial statement audit and/or an “attestation on internal controls” (whether as required or voluntary) be required to forward a copy of the auditor’s report to NCUA? If so, how soon after the audit period-end? If not, why not?

The answer to this is dependent upon what the NCUA would use the information for. In general, these should be provided by each credit union to NCUA for use in their regulatory oversight. A deadline of 150 days after the fiscal year-end is appropriate and should provide enough time for credit unions to comply.

*Question No. 18:* Should part 715 require credit unions to provide NCUA with a copy of any management letter, qualification, or other report issued by its external auditor in connection with services provided to the credit union? If so, how soon after the credit union received it? If not, why not?

No. I believe these matters should be left to the Supervisory Committee and the Board of Directors to address and consider, and I do not believe that NCUA’s ability to perform its regulatory oversight would be significantly enhanced if these items were provided. If this is required, it is important for the NCUA to distinguish between communications that involve material weaknesses in internal controls and/or “reportable conditions” versus management letters that communicate areas for improvement in controls and the auditor has determined that there are no material weaknesses or reportable conditions.

*Question No. 19:* If credit unions were required to forward external auditor’s reports to NCUA, should part 715 require the auditor to review those reports with the Supervisory Committee before forwarding them to NCUA?

Yes, always. Because it is the Supervisory Committee’s responsibility to review those reports and consider them in their oversight of the credit union.



*Question No. 20:* Existing part 715 requires a credit union's engagement letter to prescribe a target date of 120 days after the audit period-end for delivery of the audit report. Should this period be extended or shortened? What sanctions should be imposed against a credit union that fails to include the target delivery date within its engagement letter?

I think this is a realistic deadline that should be retained. As far as sanctions are concerned, perhaps linking noncompliance to an additional premium cost for NCUA insurance would be appropriate and encourage credit unions to adhere to the deadline. After all, risk is higher.

*Question No. 21:* Should part 715 require credit unions to notify NCUA in writing when they enter into an engagement with an auditor, and/or when an engagement ceases by reason of the auditor's dismissal or resignation? If so, in cases of dismissal or regulation should the credit union be required to include reasons for the dismissal or regulation?

No. This oversight and responsibility should be that of the Supervisory Committee. Credit unions are not publicly traded companies. Please don't regulate them as if they are.

*Question No. 22:* Should credit unions Supervisory Committees be prohibited by regulation from executing engagement letters that contain language limiting various forms of auditor liability to the credit union? Should Supervisory Committees be prohibited from waiving the auditor's punitive damages liability?

Yes to both questions. However, hopefully this issue will be resolved in the CPA arena since the AICPA is addressing this matter and will likely prohibit this type of language in engagement letters because it doesn't serve the public interest.